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REPORT NO. 4

FOREST SERVICE TIMBER APPRAISALS

SITUATION REPORT

FOREST SERVICE ● U.S. DEPARTMENT OF AGRICULTURE ● JULY 1969

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ROCKY MOUNTAIN STATION

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FOREST SERVICE TIMBER APPRAISALS

Situation Report

PRESENT SITUATION:

On July 11, 1969, the Forest Service, U.S. Department of Agriculture announced that it was instituting use of updated appraisal data for timber sale offerings on the National Forests to reflect more accurately the current low prices of lumber and plywood markets.

The action affects new timber sale offerings, the re-offering of a number of sales which received no bids during the last fiscal year ending June 30, and a number of sales originally advertised for July bid opening. These will all be reoffered at the revised price levels as quickly as possible.

The action does not constitute a change in the basic appraisal procedure followed by the Forest Service. It is only a change that updates selling price data of lumber and plywood on which all appraisals are based. Such selling price data has lagged seriously in recent weeks behind an unprecedented rapid drop in prices. This lag when added to the mandatory advertising period of a minimum of 30 days caused appraisals in many cases to be high at the time of the bid openings in June.

The effect of the action is expected to bring about a substantial decrease in the price of timber in a typical sale. In one sample case by which the new data were tested, the average minimum stumpage rate before adjustment was $54.70 per thousand. After adjustment it appraised at $34.88 per thousand.

In the western Oregon and western Washington Douglas-fir belt where most June offerings were sold readily, appraisal reductions will be somewhat less on the average than those throughout the western pine area. It is expected that reductions in the Douglas-fir belt may range between $5.00 and $10.00. The lesser reduction there is caused by major differences between the Douglas-fir and western pine regions. In the latter, sale prices are automatically changed or "escalated" every three

months in proportion to changes in lumber prices. In the Douglas-fir region prices bid are "flat rates," with no escalation. Also, a large component of west side Douglas-fir is used for high quality plywood. In the Western pine region plywood is a smaller component, and of much lower quality.

Appropriate adjustments are also being made in appraisals of softwood sawtimber in the East.

During the 30-day period of advertising new sales, prospective purchasers will have the opportunity to familiarize themselves with the details of the changes. The most significant change results from the updating and shortening of the base period used to adjust the lumber selling prices in each appraisal during periods of very rapid fluctuation of the lumber and plywood market.

BACKGROUND:

The wood-producing industry, as with many other sectors of private enterprise, is subject to economic forces of supply and demand. In 1969, it has experienced, in the matter of a few months, record high prices for its products, followed precipitously by extreme low prices.

In the last two weeks of June 1969, the industry began leveling charges that Forest Service appraisals of timber were too high, making production costs prohibitive and forcing mills to close.

In those last two weeks, the industry called for immediate changes in Forest Service appraisal and sale procedures in offering National Forest timber sales. It specifically demanded an immediate withdrawal of all sales being advertised, re-appraisal of those sales to lower minimum prices and re-scheduling of the sales at these lower appraisals.

Just three months before, when market price and demand were at record highs, industry had called for making more Federal timber available immediately, with no mention at the time of Forest Service appraisal levels. These were their reactions to the crests and troughs of supply and demand forces in the economy.

APPRAISAL SYSTEMS:

Here is how the Forest Service appraisal system worked prior to the July 11 announcement.

On all National Forests in the western pine region Forest Service appraisal prices reflected market index prices for the immediately previous quarter (or previous 3 months). Since there is always a time lag between date of lumber sales and date of the compiled reports, and between date of advertisement and date of purchase of timber, advertised prices were above the market on sales for which bids were opened in June. Sales in the western pine region have a contract provision for automatic escalation of bid prices every calendar quarter which adjusts for 50 percent of market changes during the life of the contract. This adjustment clause tends to average out price fluctuations.

The adjustment is determined by taking 50 percent of the difference between index price at time of bid and index price at time of harvest. The figure determined is added to, or subtracted from the bid price.

During a period of rising prices, industry pays only 50 percent of the rise in market price that occurs in the time lag between date of bid and time of harvest. This was the case during 1968 and early 1969 as prices rose considerably. Conversely, when the market declines, as it did in the last quarter of the fiscal year, 50 percent of the drop in the price index is subtracted from the bid price.

However, the sudden drop in market prices caught industry in a situation where appraisal prices for many Forest Service sales offered in the last part of the fiscal year ending June 30, 1969 were quite high in comparison to the then current market. This was due to the fact that the basic index price data available included the portion of the 1969 year in which lumber and plywood prices had been extremely high.

Of course, the adjustment clause will absorb 50 percent of the price drop at time of harvest, but the drop had been so drastic, the 50 percent not absorbed by the adjustment clause is considerable. Also, the drop is not reflected in escalation sales until 3rd quarter 1969 data is in, which will be early in October. Both 1st and 2nd quarter indices were at record high levels for all western species.

For the area west of the Cascades (western Oregon and western Washington), this adjustment system also at one time prevailed, but at industry's insistence, the system was taken out several years ago. In this area, the Forest Service deter-

mined its appraisals from an average index price for the most recent four calendar quarters, with no adjustment clause. Because of the longer time span used for a base, sharp fluctuations tend to be evened out.

With the "four-most-recent-quarters" system west of the Cascades, the highs of the most recent quarter were balanced off by the relative lows of the previous three quarters. Thus, appraisals were close to the current market prices. Almost 98 percent of tracts offered for sale in this area during fiscal 1969 were sold. It was necessary to change this because the 4-quarters average, when updated at the end of the 2nd quarter of 1969, would have been higher, whereas lumber and plywood prices were lower, than during the previous period.

CHRONOLOGY OF EVENTS LEADING TO UPDATING OF DATA:

Industry did not balk at appraisals when markets were rising during 1968 and the first quarter of 1969 because it was producing lumber and plywood from timber purchased at comparatively low prices in previous months.

As a matter of fact, by February 1969, bidding competition for National Forest timber had increased, sometimes almost hysterically, to the point that in one National Forest sale in California, a company bid four times the Forest Service appraised price. It was during this period of high prices and high demand that President Nixon ordered an increase in timber sales totaling 1.1 billion board feet through fiscal year 1970.

Then, by March, rising interest rates and tightening loan money for housing began to cut demand. As the rate of housing starts dropped rapidly, so did the prices for lumber and plywood.

While it had taken 20 months for prices to rise to their record level, they took only three months to tumble back to their early 1968 level. Quarter-inch AD grade plywood, the traditional indicator for that industry, dropped from a high of $144 per thousand square feet in March to about $64 in late June. Lumber prices followed the same general course, but at a slower rate.

By the beginning of June 1969, the industry in the pine regions of the Far West began requesting that the Forest Service withdraw sales and re-appraise the timber to lower figures. By the last half of June, the industry demands had spread to the Douglas-fir belt west of the Cascades in Oregon, Washington, and northern California.

The Bureau of Land Management, with a different system of appraisal bases, had already come under strong fire. On June 19, the BLM announced it would withdraw all its advertised sales from the market and re-appraise them. Most of these sales were offered west of the Cascades. When the BLM withdrew and re-appraised these sales they were brought down to somewhat higher than Forest Service levels for the same area. Actually, there was no "withdrawal" as such, because sales were immediately reappraised and offered on scheduled bid dates in June.

The reappraisal action by BLM involved only a comparatively few sales, but with this as its precedent, the industry then turned its attention to the Forest Service with its hundreds of advertised sales offering three billion board feet.

The following week, members of Congress met with President Nixon to discuss what he called the "current inequities caused by the Forest Service and Bureau of Land Management harvest and bidding policies."

On June 24, a delegation of western lumber and plywood producers held a meeting with Agriculture Secretary Clifford Hardin, again requesting the immediate withdrawals of sales for the rest of the fiscal year. He was told by the industry group that the inability of lumber and plywood producers to operate on "overpriced" timber would negate the action of the President in directing increases in cut from National Forests. During this week, meetings by industry spokesmen were also held with the staff of the President's Council of Economic Advisers and a delegation of western legislators from 12 States.

On June 26, Sen. Joseph M. Montoya of New Mexico announced plans to conduct hearings on Forest Service timber sales policies.

On June 27, the Secretary, after meeting with Forest Service officials agreed that sales should be continued as advertised until July 1. Any sales not sold then would be re-appraised and put up for sale again as quickly as possible, many of them in July.

The job of withdrawing sales during the latter part of June would have meant withdrawing some 500 sales totaling about 3 billion board feet. This would have resulted in a considerable time lag because of the physical process of massive re-appraisal and re-advertisement. Some sectors of the industry itself would have suffered because needed individual sales would have been unavailable.

Actually, industry did purchase 1.2 billion board feet during the period in which it sought to have all sales withdrawn and re-appraised. Of the 3,500 sales scheduled by the Forest Service during fiscal 1969, 350 tracts of timber were not purchased. They contain 1.8 billion board feet.

The 350 tracts not sold in the fiscal year ending June 30, 1969, were for the most part offerings made east of the Cascades where appraisals were based on index prices for the most recent quarter or 3 months, with 50 percent escalation adjustments made at time of harvest.

METHOD OF UPDATING DATA TO MEET PRESENT SITUATION, AS OF JULY 11, 1969:

In the areas of the United States where appraisals would normally be based on the average of the immediately previous quarter (second quarter of 1969), a composite average of indices reflecting May and June sales transactions are being used for July sales. In western Oregon and western Washington, where the normal base period has been the most recent four calendar quarters, a two-part program of base periods has been set up. For Douglas-fir, a three-month composite will be used (April, May, June sales transactions) and a two-month composite (May, June sales transactions) for other species. The two-month composite was selected for other species because other species are not used to produce high quality plywood as is coast type Douglas-fir.

Trends in the market will be carefully analyzed in the immediate future to determine when it is appropriate to shift back from the composite index to the more normal periods used in the past when market levels were more stable.

QUESTIONS AND ANSWERS:

Q. Where does the Forest Service get its information for the lumber or plywood price indices which are used in estimating product selling values, the first step in appraising timber for sale?

A. For lumber, we use indices published by the Western Wood Products Association; for plywood, we use two kinds of indices: one published by the Bureau of Labor Statistics and the other compiled by us from information obtained from the American Plywood Association. For some species we use log selling prices--an alternate approach.

Q. What is stumpage value?

A. The value of timber standing "on the stump." It is the value to be paid by a logger or manufacturer for the right to cut a tree down and haul the logs from national lands.

Q. The Forest Service System as previously operated, apparently worked until this unusual price drop came along. Is it intended to return to the previous procedures after this crisis?

A. Actually, this is not a change in the Forest Service system. It is a temporary updating of data made because market prices have changed so rapidly. We plan to observe trends of the market carefully during the immediate future to determine when it is appropriate to shift back to our normal base periods. We are hopeful the market will stabilize in the next several months, so as to permit us to shift back.

Q. Were a large number of timber sales withdrawn from the market after they had already been advertised at higher prices?

A. No. Only a comparatively few which had been advertised for bid opening in late July were withdrawn. For those in June, we conducted sales as scheduled, and are appraising and reoffering only those which drew no bids.

Q. Were there many sales by the end of the fiscal year June 30 which did not draw bids?

A. Yes. About 350 sales containing 1.8 billion board feet. These will all be back on the market as soon as possible at the new appraised prices. The 350 sales were about 10 percent of the fiscal year sales.

Q. What went wrong with the appraisal system to make it necessary to change?

A. First of all, it is not a change in the basic system; only an effort to obtain more current lumber and plywood price data as a basis for appraisal and a shortening of the period of time from which the data were gathered.

The reason for the modifications was the precipitous drop in the prices of lumber and plywood during the second quarter of 1969, after reaching record peaks during the first quarter.

Changes of the magnitude experienced this year were far greater than had ever been experienced before. It is unlikely that any system depending on comprehensive compilation of data would have coped with this plunge, but it did dramatize the need to overcome a lag between the data and the current market in such unusual swings of the market.

Q. What does the word "appraise" represent in connection with timber sales?

A. The Forest Service by law must sell timber at not less than its appraised value. By definition to appraise something is to estimate its value. Estimated selling values, costs, and profits are included in an appraisal of timber value. The appraised value is the least that the Forest Service can accept in payment for National Forest timber.

The appraisal price is determined by subtracting the costs of a prospective buyer's operation in getting the timber out of the forest and manufacturing it into wood products, as well as a reasonable margin for profit, from the lumber and plywood selling values. The amount remaining after these subtractions is the appraised price.

When a timber sale is advertised, minimum prices are listed by species. A prospective buyer can bid on the timber, but a price lower than the advertised figure cannot be accepted.

Q. When industry requested in June that current sales be withdrawn from the market, appraised at lower levels, and readvertised, why did the Forest Service object?

A. We felt it would cause undue hardship to some prospective timber buyers, while achieving no good end. The sales involved a large volume of timber needed by industry to sustain operations for the future. Many sales were drawing

bidders, so we knew much of the timber was wanted. In fact, in the Douglas-fir belt of western Oregon and western Washington, less than 2 percent of our sales offerings up to the end of the fiscal year, June 30, received no bid Furthermore, the Administration had previously agreed and had taken steps to increase timber sales.

To avert any hardships to those who did want to buy the timber, Chief Cliff agreed that timber not sold would be promptly reoffered at lower prices, if new appraisals justified such lower prices.

Q. Why should the Federal Government lower its prices on timber when at least some segments of the lumber and plywood industry have reported record profits in the first half of the year?

A. These profits, of course, were chalked up when lumber and plywood prices were extremely high. That picture is no longer true. In a short span of time, prices have dropped spectacularly to much lower figures. Some mills have extended their annual vacation periods, and others have indicated their intentions to close because of the economic difficulty of operating with high-priced timber. This could in turn tend to limit lumber supplies to consumers later in the year. Holding prices at very high levels would conflict with one purpose of Forest Service timber policy of providing sufficient timber at reasonable prices to meet the needs of the American people.

We feel it is only equitable now to try to make the appraisal prices more accurately reflect the current lumber and plywood market.

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